No. 557

IN THE

Supreme Court of the United States

OCTOBER TERM, 1940

IDA C. HAZZARD, ET AL., Petitioners,

v.

THE CHASE NATIONAL BANK OF THE CITY OF NEW YORK.

PETITION FOR WRIT OF CERTIORARI TO THE SUPREME COURT OF THE STATE OF NEW YORK

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Petitioners,

against

THE CHASE NATIONAL BANK OF THE CITY OF NEW YORK.

PETITION FOR WRIT OF CERTIORARI TO THE SUPREME COURT OF THE STATE OF NEW YORK

TO THE HONORABLE, THE CHIEF JUSTICE AND ASSOCIATE JUSTICES OF THE SUPREME COURT OF THE UNITED STATES:

Petitioners, plaintiffs below, one hundred and twenty-five debenture holders of National Electric Power Company[1] are resident throughout the United States and include National and State banks[2]. They pray that a writ of certiorari issue to review the final judgment, entered on March 22, 1940 (R. 3692-3694), upon the remittitur of the Court of Appeals, the highest Court of New York State (R. 3690-3691), affirming intermediate New York State Court judgments entered July 13, 1939 (R. 3686-3687) and July 1, 1936 (R. 142-143) in favor of The Chase National Bank of the City of New York,[3] dismissing petitioners' complaint on the merits, following an equity trial.

Opinions Below

The opinion of the Trial Court is reported in 159 N. Y. Misc. 57 (R. 3635-3678). The Appellate Division of the New York Supreme Court, in affirming, some six months after argument, wrote no opinion (257 N. Y. App. Div. 950; R. 3684-3685). At its next term, it granted leave to appeal to the Court of Appeals, certifying "that in its opinion a question of law is involved which ought to be reviewed" (258 N. Y. App. Div. 709; R. 3683-3684). The Court of Appeals in affirming, wrote no opinion; Rippey, J. dissenting without opinion, and Finch, J. taking no part (282 N. Y. 652; R. 3690-3691). In denying petitioners' motion for re-argument and amendment of the remittitur, the Court of Appeals, however, wrote a short memorandum opinion which is reported in 283 N. Y. 132 (R. 3705).

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[1]Hereinafter called "NEP".

[2]e.g. Bay Trust Company of Michigan (R. 9); Ridgeway State Bank of Illinois (R. 10); Peoples Savings Bank of Wisconsin (R. 21); Kent National Bank of Washington (R. 30). The suit was instituted in 1933 under the auspices of the Bondholders Protective Committee of Boston, Massachusetts (R. 373-375).

[3]Hereinafter called "CHASE NATIONAL".

Jurisdiction

1. The jurisdiction of this Court rests on Section 237 of the Judicial Code, as amended by the Act of February 13, 1925 (28 U. S. C. A., Sec. 344).

2. Final judgment was entered on March 22, 1940 (R. 3692-3694) upon the New York Court of Appeals remittitur (R. 3690-3691). On May 24, 1940, petitioners seasonably applied to the Court of Appeals for re-argument, amendment of the remittitur and other relief (R. 3707-3723). This motion was denied on June 11, 1940, "on the ground that it does not present either authority or reason for changing our decision" (R. 3705; cf. *Gypsy Oil Co.* v. *Escoe,* 275 U. S. 498; *United States* v. *Seminole Nation,* 299 U. S. 417). On September 6, 1940, this Court by order signed by Justice Black, extended petitioners time to file the instant petition and record for sixty days from September 11, 1940 (R. 3724; cf. 28 U. S. C. A. 350).

3. The following authorities sustain the jurisdiction of this Court since petitioners specifically set up Federal rights under a Federal statute: *National Banking Act,* 12 U. S. C. A.; *M'Culloch* v. *Maryland,* 4 Wheat. 316; *Osborn* v. *Bank of United States,* 9 Wheat. 738; *Easton* v. *Iowa,* 188 U. S. 220; *Yates* v. *Jones National Bank,* 206 U. S. 158; *Jones National Bank* v. *Yates,* 240 U. S. 541; *First National Bank* v. *Fellows, Ex Rel. Union Trust Co.,* 244 U. S. 416; *Missouri Ex Rel. Burnes Nat. Bank* v. *Duncan,* 265 U. S. 17; *Ex Parte Worcester County Nat. Bank,* 279 U. S. 347; *Awotin* v. *Atlas Exch. Nat. Bank,* 295 U. S. 209; *Deitrick* v. *Greaney,* 309 U. S. 190; *Inland Waterways Corp.* v. *Young,* 309 U. S. 517; *City of Yonkers* v. *Downey,* 309 U. S. 590; *Colorado National Bank* v. *Bedford,* 310 U. S. 41.

Also the decision below was arbitrary and capricious, in violation of settled principles of law, contrary to undisputed facts, and in disregard of formal concessions by Chase National, petitioners were unconstitutionally de-

prived of their property, without due process of law, as required by the Fourteenth Amendment (cf. *Scott* v. *McNeal,* 154 U. S. 34; *Postal Tel-Cable Co.* v. *Newport,* 247 U. S. 464; *Williams* v. *Tooke,* 108 F. (2d) 758; cf. *Schofield, Federal Supreme Court and State Law,* 3 Ill. L. Rev. 195).

4. The questions involved are substantial. This will clearly appear from the "Statement" *infra.* Should this Court determine that any National Bank trustee, under Federal law and policy, is a fiduciary, subject to a Federal standard of minimal duties and disabilities springing from the fiduciary relationship, then, upon the findings below (even excluding formal concessions and undisputed facts) it inevitably follows that CHASE NATIONAL must be removed as trustee and held to account.

This cause was tried and submitted by petitioners and CHASE NATIONAL upon the basic recognition that any trustee is a fiduciary. CHASE NATIONAL, conceded in writing at the trial "that a corporate trustee may have certain *implied* "duties beyond those expressly imposed on it by the trust in- "denture" (R. 1808; 1805-1809). Nevertheless, the Trial Court, in an opinion written weeks after the trial, held that the word "trustee" is a "misnomer"; that "undivided "loyalty" was not required; that this trustee's "duties" were "defined, not by the fiduciary relationship, but exclusively "by the terms of the agreement"; that its "status" is more that of a "stakeholder" and that the "rule of trustee and "*cestuis* is not the one to be applied here, either by agree- "ment or implication" (R. 3674-3675; 3672). He clearly recognized that were CHASE NATIONAL invested with the slightest of the duties or disabilities of any fiduciary, it would be removed and required to account, since "the acts "of the trustee would be a distinct violation of the well- "recognized obligations arising from such relationship" (R. 3666).

There was thus created the concept of a non-fiduciary trustee. This cast aside the ancient and universal law and

equity jurisprudence of trusts and fiduciaries. The State Courts' basic error followed. CHASE NATIONAL, this trustee, was not charged with the minimal fiduciary duties of "un-"divided loyalty (R. 3672-3675) and "full disclosure." There were thereby stripped from the shoulders of this "inconsistent", "negligent" and damaging trustee (R. 138), the fundamental "burdens of explanation and justification" (R. 3674). Instead there was thrust upon the bondholders (the *cestuis*), themselves, the burden of proving by a preponderance of evidence that "bad faith" predominated in the minds of the trustee's officers and agents; their evil intent; their "mental "attitude of reckless and wanton disregard of the rights of "others" (R. 3646; 3654; 3666; cf. R. 3712-3714).

Upon the application for re-argument and amendment of the remittitur, petitioners' Federal rights and claims were squarely presented (R. 3714). CHASE NATIONAL opposed, not upon the merits, but by oblique suggestions that if the amendment be denied, then the *cestuis* might be impeded in obtaining a review in this Court (R. 3699-3705; cf. 3694-3698). Thereupon, the Court of Appeals, in denying the motion, wrote a one sentence opinion. It contains self-contradictory statements, to wit "the liability of the corporate "trustee though acting as a fiduciary was limited by the "terms of the trust agreement." The "ground" of the denial was that the motion "does not present either authority "or reason for changing our opinion" (R. 3705). Clearly, the Court of Appeals considered and passed upon the Federal questions presented.

There can be no "fiduciary" without fiduciary duties or disabilities. By very definition a fiduciary is one upon whom there are duties imposed by law. These transcend and rise superior to contractual limitations. A fiduciary without fiduciary obligations, or those which can be obliterated by contract, is no fiduciary in any sense of the term.

CHASE NATIONAL, in its most recent interpretation of its own status, wrote: "Whether the trustee was a national "bank, a state bank or an individual was immaterial in this

"case" (R. 3701). That statement is a challenge. Upon the findings, concessions and undisputed facts, is it "immaterial "in this case" that petitioners were betrayed by a National Bank fiduciary trustee and not by a State bank or an individual? Under Federal law and policy can minimal duties and disabilities of a National bank fiduciary trustee be abridged by contract or by State fiat?

5. Due to the unusual way in which the Federal questions were first eliminated by concession, then restored by a disregard of that concession, again eliminated in the Appellate Courts by similar concessions, and again restored by similar disregard, it is necessary fully to explain the sequence of events to show the stage at which the Federal questions were raised, the manner in which they were raised, and the way they were passed upon below:

(a) The Federal standard of the minimal duties and disabilities of a National bank fiduciary trustee, is essentially a Federal question and necessarily existed throughout the case. The very first finding (proposed by CHASE NATIONAL), predicated upon an issue raised by the pleadings, determined that CHASE NATIONAL was a "National Banking Corporation "duly organized and existing under the laws of the United "States" (R. 45-46; 223-224).

(b) Throughout the trial, there was no issue respecting the legal proposition that any trustee (National bank or otherwise) is a fiduciary, charged by law with minimal duties and disabilities springing from the relationship, regardless of the words of the trust indenture. This was then conceded in writing by CHASE NATIONAL (R. 1808). The issue tried was whether, in fact, there had been a breach of such conceded duties. These were abundantly proved and expressly found (cf. "Statement", *infra*). Upon the theory of the trial, such breaches should have required the removal of the trustee and its compulsion to account.

However, weeks after the trial, the Trial Court changed the conceded theory of the trial. In his opinion, CHASE NA-

TIONAL was condemned, but relieved from liability because it was then determined that a mortgage indenture trustee was no fiduciary at all (e. g., R. 3674-3675; 3672).

In the Appellate Division, and despite the Trial Court's metamorphosis of the case, CHASE NATIONAL repeated its prior concessions.[4] Petitioners could scarcely argue to that Court what the effect would have been for a National bank trustee to deny that it was a fiduciary, while that National Bank continued to concede that basic proposition. These concessions were not withdrawn in the Court of Appeals (R. 3713).

When the majority of the Court of Appeals affirmed without opinion, and the dissent was without opinion, the *ratio decidendi* was still unknown. Therefore petitioners expressly presented to the Court of Appeals the Federal questions and repercussions involved in a determination that a National bank, acting as a trustee, was no fiduciary. That Court then stated that the argument and direct presentation of the Federal questions did "not present either authority or rea-"son for changing our decision that the liability of the cor-"porate trustee though acting as a fiduciary was limited by "the terms of the trust indenture" (R. 3705).

In short, the Trial Court predicated his release of CHASE NATIONAL, in holding, contrary to its concessions, that this National Bank was not a fiduciary. The Court of Appeals has sustained his result by holding that CHASE NATIONAL is a fiduciary; but that its fiduciary duties are only those expressly set forth in a contract. In other words, a National bank fiduciary may traffic in its trust, if the trust indenture either permits or does not forbid such conduct. Will this Court leave undisturbed so immoral a view?

(c) Petitioners' Federal rights were asserted and the federal questions here presented were squarely raised, upon the

[4]CHASE NATIONAL admitted: "A trustee under a corporate mortgage indenture is actually a trustee." "The fundamental duty and obligation of one undertaking to hold, for the protection of another, a security for a debt, is the preservation of that security" and "the rule of undivided loyalty is applicable to corporate trustees under mortgage indentures" (R. 3713).

application for re-argument in the Court of Appeals. These questions were presented by order to show cause issued by the Chief Judge (R. 3707-3723). CHASE NATIONAL submitted opposing papers (R. 3699-3705) to which we replied (R. 3694-3698). Upon these papers the Court of Appeals denied the motion on the "ground that it does not present either authority or reason for changing our decision" (R. 3705). The Federal questions were properly presented and the Court of Appeals actually entertained and decided them (cf. *Herndon* v. *Georgia,* 295 U. S. 441, 443).

(d) Prior to the affirmance by the Court of Appeals it was inconceivable that that Court, despite prior settled New York as well as universal law and traditional equity jurisprudence, and despite the concessions of CHASE NATIONAL, would countenance the concept of a non-fiduciary trustee[5]. Under such circumstances, there "is no doubt that "the federal claim was timely", since "the ruling of the state "court could not have been anticipated and a petition for "rehearing presented the first opportunity for raising it" (*Herndon* v. *Georgia,* 295 U. S. 441, 444; cf. *Missouri Ex Rel. Missouri Ins. Co.* v. *Gehner,* 281 U. S. 313; *Brinkerhoff-Faris Trust & Savings Co.* v. *Hill,* 281 U. S. 673; *Mahler* v. *Eby,* 264 U. S. 32; *Tidal Oil Co.* v. *Flanagan,* 263 U. S. 444; *Great Northern Ry. Co.* v. *Sunburst Oil & Refining Co.,* 287 U. S. 358; *American Surety Co.* v. *Baldwin,* 287 U. S. 156; *Fleming* v. *Fleming,* 264 U. S. 29; see also, *Whitney* v. *California,* 274 U. S. 357; *Home Insurance Co.* v. *Dick,* 281 U. S. 397; *Saunders* v. *Shaw,* 244 U. S. 317).

[5]The *Benton* case cited by the Court of Appeals (R. 3705) is wholly inapplicable to our own. No "inconsistent" trustee was remotely involved. The facts bear no resemblance to those here found. The result in the instant case should be contrasted with that earlier expressed by the same Court through its then Chief Judge, Cardozo, in *Meinhard* v. *Salmon* (249 N. Y. 458, 464): "A trustee is held to something stricter than the morals of the market place. Not honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behavior. As to this there has developed a tradition that is unbending and inveterate. Uncompromising rigidity has been the attitude of courts of equity when petitioned to undermine the rule of undivided loyalty by the 'disintegrating erosion' of particular exceptions. Wendt v. Fischer, 243 N. Y. 439, 444, 154 N. E. 303. Only thus has the level of conduct for fiduciaries been kept at a level higher than that trodden by the crowd. It will not consciously be lowered by any judgment of this court."

Questions Presented

1. Whether, under Federal law and policy, independent of any particular State's fiat (Judicial or Legislative) or private contract, a National Bank Federally licensed "to act as "trustee" "or in any other fiduciary capacity" (12 U. S.. C. A. 248 (k)) is charged with and subject to minimal fiduciary duties and disabilities.

2. Whether, under Federal law and policy, a National Bank acting under a trust indenture by power granted pursuant to the National Banking Act, is charged with and subjected to a Federal standard of minimal fiduciary duties and disabilities of "undivided loyalty" and "full disclosure" to the beneficiaries of the trust.

3. Whether, under Federal law and policy, a National Bank fiduciary trustee, which was expressly found by a State Court voluntarily to have assumed an "inconsistent" role, to have been "at least negligent", to have failed to act "as a reasonably careful person" and to have thereby "damaged" its *cestuis,* may, by any particular State's fiat (Judicial or Legislative) or by private contract be absolved from the burdens of explanation and justification.

4. Whether, under Federal law and policy, the standard of the minimal duties and disabilities of a National Bank acting as a "trustee" "or in any other fiduciary capacity" under the National Banking Act, is measured solely by such law and policy and cuts across and supersedes State law or policy.

5. Whether, when CHASE NATIONAL accepted the post of trustee for petitioners, its *cestuis,* it was by force of Federal law and policy bound to act as a fiduciary charged with and subjected to the minimal duties and disabilities flowing from any fiduciary obligation.

6. Whether the basic determination below, that CHASE NATIONAL acted in relation to petitioners, its *cestuis,* either as a non-fiduciary trustee, or as one which could by contract

limit its fiduciary obligations, is not incompatible and in conflict with paramount and controlling Federal law and policy.

7. Whether, since the National Banking Act constitutes "by itself a complete system for the establishment and gov-"ernment of National Banks", the determination below that CHASE NATIONAL is not charged with and subject to minimal fiduciary duties and disabilities, does not impair, impede and destroy the efficiency of such quasi-governmental agency to discharge the duties and obligations imposed upon it by Federal law and policy; frustrate its public purposes; nullify the command of the National Banking Act; and abrogate Federal safeguards for petitioners and the public.

8. Whether the determination below is so arbitrary and capricious a departure from previously settled New York law, as well as universal law and traditional equity jurisprudence, the concessions of CHASE NATIONAL, and the undisputed facts, as to violate a Federal right of petitioners and thereby unconstitutionally deprives them of their property without due process of law.

9. Whether, under Federal law and policy the New York State Courts were correct in deciding that the beneficiaries of a National Bank fiduciary trustee which had damaged them by a negligent substitution of the trust *res* at a time when it occupied a position adverse to them, must, in addition to proving that such trustee stood to profit and did profit from such substitution, also affirmatively establish the trustee's intent to profit.

10. Whether the New York Court of Appeals was correct in deciding when it denied petitioners' motion for reargument and amendment of the remittitur, that the liability of CHASE NATIONAL "though acting as a fiduciary was limited "by the terms of the trust agreement", despite applicable and controlling Federal law and policy.

Statutory and Constitutional Provisions Involved

The relevant portions of the National Banking Act, as amended, are set forth in the Appendix, *infra*, pages 39-40.

The relevant portions of the Constitution are set forth in the Appendix, *infra*, page 40.

Statement

The record in this case consists of seven volumes and a supplement. In the interest of brevity we shall set forth only the more material facts *expressly* found below, except in a few instances where we quote uncontradicted testimony of CHASE NATIONAL's own witnesses and from "the not always "cooperative lips and files of the trustee itself" (R. 3678). In no instance do we quote the highly credible testimony of our own witnesses. The Findings are infinitely stronger than the statements of fact made in the opinion. The record is yet stronger than the Findings.

The holders of NEP 5% "Secured" Gold Debentures seek the removal of CHASE NATIONAL as their trustee and to compel that National Bank either to return the securities removed from their trust on December 21, 1931, or to respond for the damages occasioned (R. 40-42)[6].

It was expressly found that CHASE NATIONAL, the trustee, was "guilty of, at least, negligence" (R. 138, 121, 122) when it "as creditor of the obligor, occupied a position inconsistent "with its role as trustee for the debenture holders" (R. 89, 97, 67) and benefitted by the substitution (R. 86-89, 83, 122, 118) which it "permitted" (R. 110, 124). It was further expressly found that the prospectus issued on the sale of the debentures named the valuable securities deposited with the trustee without mention of the power of substitution (R. 59-60).

Finding: "42. The plaintiffs and other debenture holders relied upon the experience, power, financial

[6]Should CHASE NATIONAL be directed to replace the securities removed from the trust, and fail to do so, the extent of the loss will be separately determined (R. 1742-1744)

acumen and integrity of the trustee CHASE NATIONAL to serve as a protection to them for their investment."

"43. By accepting the designation as 'Trustee' CHASE NATIONAL represented to plaintiffs that it would exercise its experience, power and financial acumen to protect the interests of debenture holders" (R. 61-62).

Despite such express findings, as well as many others to some of which we hereinafter refer, the Trial Court held that by virtue of its interpretation of certain exculpatory clauses contained in the indenture, CHASE NATIONAL was really no trustee and had no fiduciary duties or disabilities. He stated that he was "reluctantly constrained to conclude that the defendant has successfully exempted itself from liability in this sad picture of high finance" (R. 3677). The Trial Court ruled that the bondholder-cestuis were required affirmatively to prove CHASE NATIONAL'S bad faith and had failed to sustain the burden of proof he thus imposed on them (R. 3646, 3664).

"The obligor, NEP, was one of the major holding companies near the top of the Insull System and dominated the Insull Empire in the Eastern part of the United States. It owned substantially all the voting stock of National Public Service Corporation.[7] Above NEP was the Middle West Utilities Company, which, in turn, was controlled by two other corporations, viz.: Corporation Securities Company of Chicago and Insull Utilities Investments, Inc., which were, in turn, controlled by the Insull family."

"NPS was likewise a holding company, and did not itself operate any utilities. It had its own senior issues of stock and its own funded indebtedness and separate creditors. Below it there was a veritable maze of sub-holding and sub-sub-holding companies and operating companies which had senior issues of stock, funded indebtedness and other obligations" (R. 47).

"The management and directorship of the various holding companies were the same, so that, in effect, the Insulls dominated the entire system, transferring and shifting loans, collateral, debits and credits from one company to another virtually at will" (R. 48).

[7]Hereinafter called "NPS".

Our NEP debenture bonds were sold to the public (including many of petitioners) early in January, 1928 (R. 59-61, 2943, 2952). It was subsequent to these sales that the trust indenture here involved was prepared and executed (R. 59, 2927, 3404-3408). "This indenture was particularly vicious" (R. 3675)—"a voluminous document of over one hundred "printed pages. It provided for the substitution of securi-"ties held thereunder under certain conditions; but the "clauses permitting substitution were so astutely tucked "away that the average layman would have the greatest diffi-"culty in discovering them. Not only the average layman, "but seasoned financial experts like those who published "Moody's Manual overlooked the power of substitution, for "until the collapse of the system, Moody's Manual in describ-"ing these debentures and the security behind them, never "mentioned the possibility of substitution of collateral" (R. 58). "The debentures themselves did not mention any right "of substitution of collateral" (R. 59). "At least some of the "plaintiffs would not have purchased these debentures had "they been informed that the security could be substituted" (R. 61). "The Ohio Electric Power Company, Michigan "Electric Power Company and Penn Central Light & Power "Company were all operating companies and the common "stock of each of them, before the substitutions, was held by "NEP directly" (R. 48).

Long prior to the substitution CHASE NATIONAL, by successive mergers, acquired both Equitable Trust Company and Seaboard National Bank (R. 49, 62). One Makepeace, "a "vice-president of CHASE NATIONAL, was at the same time a "director of NEP and of NPS. He was also a member of "the Executive Committee of NPS. During all of the time "he was a member of these boards he had been successively "an officer of Seaboard National Bank, Equitable Trust Com-"pany and of CHASE NATIONAL, all of which banks succes-"sively merged. Whatever the bank with which Makepeace "was connected at any period of NEP'S history, that bank "was the principal bank of NEP. Makepeace was an offi-

"cer of CHASE NATIONAL, receiving in 1931 an annual salary "of $45,000. * * * Makepeace purported to represent the de- "fendant, CHASE NATIONAL'S interests where it was neces- "sary or advisable to do so while on these boards" (R. 63-64).

CHASE NATIONAL thus simultaneously acquired Makepeace and became our substituted trustee. The record abounds with illustrations of the strenuous, undignified efforts made by this National Bank to procure Insull business (R. 3067-3070, 3075), before utility values started crashing after August of 1931 (R. 3667). CHASE NATIONAL thus became "the largest single creditor of NEP" (R. 67), and a creditor of "Corporation Securities Company of Chicago, the ultimate stockholder of NEP" (R. 75). It made loans "to Martin "J. Insull, chairman of the board of NEP and NPS of "$2,000,000 and $2,500,000 * * * respectively" (R. 76); to "Hary Reid, President of NEP and NPS * * * in the sum "of $80,188.89" (R. 80); "to Reid and Insull jointly" for $550,000 (R. 81); to "Zeigler, Treasurer of NEP and NPS, "which * * * aggregated $276,000" (R. 82).

> "In dealing with loans made alike to the various companies and corporate officers in the Insull system, CHASE NATIONAL, for its own purposes, grouped all such loans together under the caption of 'Loans to Insull Group'. In all, the total loans made by CHASE NATIONAL to the Insull group were $12,520,000. The collateral for all of these loans was in greater part the securities of some part of the so-called Insull system" (R. 84).

There was specially prepared and sent to Wiggin (R. 2985) a list of the hundreds of different items of business transactions thus built up between CHASE NATIONAL and the "Insull "Group" (R. 2978-2997), including "commercial accounts", "checking accounts", "trust business" and "pay and charge "arrangement" (R. 2991).

Then followed what the Court described as the "financial "debacle", and "precipitous decline of utility earnings" (R. "121, 3667). "The decline in market value of the collateral

"securing the loans to Martin J. Insull, including the se-
"curities of Corporation Securities Company of Chicago and
"Insull Utility Investments, Inc., during the summer and fall
"of 1931 caused the defendant CHASE NATIONAL to make"
"from the summer of that year until December 16, 1931"
"repeated calls for additional collateral" "increasingly fre-
"quent" "almost a daily occurrence" "until about December
"16, 1931" "Insull furnished additional collateral comprising
"primarily stock of Insull Utilities Investments, Inc. and
"Corporation Securities Co. The attention of the Discount
"Committee" was "specifically drawn to the nature of the
"additional collateral" "CHASE NATIONAL was much con-
"cerned over the large proportions of stock of Insull Utility
"Investments, Inc. and Corporation Securities Co." "many of
"the responsible officers of CHASE NATIONAL took active and
"important parts in handling these loans. Among them"
"* * * "Wiggin, McCain", "McHugh", "Aldrich", "Sherrill
"Smith, Makepeace and Schmidlapp" (R. 77-78).

"On the date of the substitution, Martin J. Insull, the
"vice-president and executive director of NEP owed CHASE
"NATIONAL $3,916,000 which he could not pay and which was
"under-collateralized" "On or about December 16, 1931,
"shortly prior to the substitution" "Insull informed Aldrich"
"that he could no longer supply additional collateral or re-
"pay the loans" (R. 79).

"Ziegler" and "Reid" "were similarly indebted to CHASE
"NATIONAL in large amounts which they could not pay" (R.
"80). "CHASE NATIONAL was well aware that the soundness
"of the obligation of NEP Company was partially dependent
"upon the soundness of Middle West and of the Insulls"
"(R. 68).

With respect to CHASE NATIONAL'S own loans to NEP, the Court found: "In each instance CHASE NATIONAL required "full information and gave careful consideration to the mat-
"ter before acceding. In each instance CHASE NATIONAL re-
"ceived collateral of equal or greater value than that sur-
"rendered" (R. 71). "CHASE NATIONAL required the operat-

"ing company collateral because NEP, NPS and Seaboard "Public Service Company were holding companies" (R. 70-71).

On December 16, 1931, CHASE NATIONAL thus received for itself the "$3,160,000 note of Central Eastern Power Com-"pany", collateralized by the stock of Central Utilities Ser-"vice Co. and the note in like amount of Central Utilities "Service Co. and also secured by subordination agreements "of NEP and Central Utilities Service Co. This substitution "constituted Chase National the chief creditor of Central "Eastern" (R. 73-74).

It will be noted that December 16, 1931 was the same date when Martin Insull, in the picturesque language of CHASE NATIONAL'S counsel, stated that he was "scraping the bottom "of his box" and "pleaded for mercy" (R. 1787).

"The $6,000,000 loan by CHASE NATIONAL to NEP was "made to be repaid in the early Fall of 1931" but "in Sep-"tember 1931, NEP was not only unable to repay its loan "from CHASE NATIONAL but requested a further loan of "$1,000,000, which was not furnished" (R. 74). CHASE NA-TIONAL'S "Makepeace was informed of pending plans to pay "off bank loans" "and also for public financing by means of "Ohio Electric Power Company"[2] (R. 74) "Makepeace knew "the inconsistent position of CHASE NATIONAL as a creditor "of NEP and as a trustee for debenture holders of NEP." He "knew of the prospectus issued in conjunction with the "sale of debentures to the public, including these plaintiffs" (R. 97). "Makepeace knew and approved the proposal to "withdraw some of the operating company stocks from under "the indenture, at least some weeks before the substitu-"tion transpired" "and substitute the stocks of NPS." He

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[1]CHASE NATIONAL did not "accept" Central Eastern until Makepeace, Martin Insull, Reid and Zeigler (a majority of the NEP board) had first voted to withdraw Ohio Electric from CHASE NATIONAL as our trustee, and then to give that withdrawn trust *res* to Central Eastern, CHASE NATIONAL'S debtor (R. 3046-3047).

[2]The stock of Ohio Electric was then still pledged under our indenture (R. 61, 48, 60).

"knew that a campaign in November to sell (NPS) Class "B stock" "in order to raise funds had failed" (R. 98).

"The plans for the utilization of the securities withdrawn "from under NEP's indenture were discussed among the di- "rectors of NEP including Makepeace from time to time "prior to the actual withdrawal on December 21, 1931" (R. 124).

December 16, 1931 (five days before the substitution) besides witnessing Martin Insull's personal collapse *supra* and CHASE NATIONAL's receipt of the Central Eastern collateral to its own loans to NEP and NPS *supra*, was the occasion of a visit by Samuel Insull, Jr. and Harry Stuart with Aldrich at which time, "CHASE NATIONAL agreed to join with other "banks holding collateral of Corporation Securities Company "against loans, in an agreement tantamount to a 'standstill' "or moratorium for four[10] months" (R. 120), "CHASE NA- "TIONAL knew that the general financial situation was crit- "ical" (R. 118).

Two days later, "on December 18, 1931, NEP made appli- "cation to defendant, CHASE NATIONAL, as trustee, for the re- "lease of the stocks of 'Penn Central', 'Michigan Electric' "and 'Ohio Electric' and the substitution therefor of 276,522 "shares of the Class A common and 444,868 shares of the "Class B common stocks of NPS" (R. 109-110). "The appli- "cation was referred to" "Buckley", "assistant trust officer "of" "CHASE NATIONAL, who made no inquiry or investigation "as to the truth or falsity of the earnings certificate" "took "no steps to verify or have verified any of the matters of fact "recited" "testified he was ignorant of the affairs of NPS and "NEP" "neither had nor sought information with respect to "value of the securities involved" "had no balance sheets, or "profit and loss statements, and made no effort to obtain "them or to ascertain market prices" "consulted no other of- "ficer of" "CHASE NATIONAL" (R. 110). Buckley sent these papers "to counsel for the trustee for approval *as to matters "of legal form only*" (R. 113).

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[10]The bankruptcy preference period.

"Though the trustee had, and was aware of, the right[11] "to make an investigation at the expense of the obligor before "granting an application for substitution, it did not make "such an investigation. The trustee did not consult any of "the debenture holders, nor call a meeting of the latter, as "it had a right to do under the terms of the indenture, before "granting an application for substitution. Buckley had been "informed on November 12, 1931 that the debenture holders "were relying upon the security of the stocks of 'Penn Cen- "tral', 'Ohio Electric and Michigan Electric' for protection" (R. 117-118).

"The trustee did not advise the debenture holders at large, "or the general public, of the fact that it had permitted a "substitution of collateral" (R. 120).

"CHASE NATIONAL, by reason of the making of" (the) "standstill agreement," (of December 16, 1931) "if for no "other reason, knew that the top holding companies of the "Insull system were in precarious condition" (R. 120).

"CHASE NATIONAL knew the close connection and inter- "dependence financially between Corporation Securities Com- "pany and the other holding companies of the Insull system; "and it, of course, knew of the standstill agreement of Decem- "ber 16, 1931" (R. 121-122).

"In December, 1931, CHASE NATIONAL knew that the In- "sull situation was difficult and promptly acted to secure and "strengthen its loans to the Insull group. Every one of these "loans was immediately reviewed, counsel consulted, addi- "tional documents and commitments from the obligors called "for, and methods of liquidation and reduction of indebted- "ness taken up with the obligors." "CHASE NATIONAL con- "ceded at the trial that after the conferences with the In-

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[11]CHASE NATIONAL was under no duty to permit the substitution. The indenture provides that it "may in its discretion make any such independent inquiry or investigation as it may see fit." "it shall be entitled to examine the books and records of the Company, either itself or by agent or attorney; AND UNLESS SATISFIED, WITH OR WITHOUT SUCH EXAMINATION, OF THE TRUTH AND ACCURACY OF THE MATTERS STATED in such resolutions, certificate, statement, opinion, report or order, IT SHALL BE UNDER NO OBLIGATION TO GRANT THE APPLICATION" (R. 57-58).

"sulls on December 16, 1931, Aldrich and Sherrill Smith "would have been neglectful of their duties to CHASE NA-"TIONAL had they not immediately made full investigation of "the status of borrowers in the Insull group and taken active "steps to protect the bank. This they concededly did" (R. 122-123).

Just as concededly, they did nothing whatever for the beneficiaries of the trust which they were administering under representation that they would protect the debenture holders. "Aldrich and Sherrill Smith knew that CHASE NA-"TIONAL was trustee for debenture holders of NEP. At least "Aldrich was in charge of the trust department of CHASE NA-"TIONAL. He owed the same duty to the trust department as "he owed to the loan department of his bank" (R. 123). "The bank balances of NEP and NPS in CHASE NATIONAL "and other banks had severely declined" (R. 121). "CHASE "NATIONAL knew all of the facts and information actually ac-"quired and learned by Makepeace as a director of NEP and "NPS" (R. 100). "Makepeace knew the inconsistent position "of CHASE NATIONAL as a creditor of NEP and as a trustee "for debenture holders of NEP. Makepeace knew that NPS "earlier *on the very day of the substitution* had been reduced "to the necessity of borrowing on the life insurance policies "of its officers for the purpose of meeting year-end require-"ments" (R. 97).

Prior to the substitution of December 21, 1931, the "invest-"ment service department" of CHASE NATIONAL had given advice "to customers of the Bank with respect to securities of "NEP and NPS" (R. 89). "CHASE NATIONAL itself as shown "by its investment and credit files, criticized adversely the "earnings reports of NPS" (R. 91). This did not deter that National Bank from its pretended reliance on earnings certificates of the same company, in "permitting" the substitution. Months before the date of the substitution CHASE NATIONAL had written: "The company's tactics in this case, "however, is to charge engineering services of this type to "property account and show the result of such increased capi-"talization as actual income available for the payment of in-

"terest and dividends" (R. 91-92), "extreme remoteness" "from actual earning power", "relatively small equity in "tangible assets", "other uncertain factors", "a very specu- "lative type of security"—"hardly possible to make an ac- "curate computation of earnings", "derives a substantial "part of the gross revenues from the less stable forms of "utility service", "funded debt and capital stocks of sub- "sidiaries are outstanding in an amount almost five times "as large as gross operating revenues" "these shares in- "volve a considerable number of unsatisfactory features" (R. 92-93).

Not only had CHASE NATIONAL, itself, thus characterized NPS *common* stock long prior to the "financial debacle" and "precipitous decline in utility earnings"; but further wrote: "that the company's *preferred* stocks occupy a rather remote "position in relation to earnings" and that its bonds were of a "junior nature", "rather poor protection afforded "them by earnings", "occupy a speculative position and "must be regarded as undesirable for conservative invest- "ment purposes", (R. 94), and wrote of NEP, our obligor, that "increasing fixed charges have caused a downward "trend in the margin of protection", "the rather unim- "pressive earnings record of the company", "preceded by "more than $230,000,000 of subsidiary obligations", "de- "crease in the degree of protection accorded", and "specu- "lative" (R. 95).

Nevertheless it was the lowest, poorest and weakest of all these issues, viz.: the Class B (and some Class A) stock of NPS which CHASE NATIONAL, as our trustee, accepted in substitution for the stocks of good operating companies.

"All of the operating company stocks pledged under the "indenture securing the debenture holders of NEP were "withdrawn; and only holding company stocks were left "as security for the debenture holders of NEP. Con- "versely put, no holding company stock was withdrawn, "and no operating company stock remained after the sub- "stitution of December 21, 1931" (R. 124-125).

"The debenture holders of NEP were damaged by the sub-"stitution of securities permitted by CHASE NATIONAL as "trustee for the debenture holders on December 21, 1931" (R. 125).

> "293. *At the time of the substitution,* CHASE NATIONAL had received and placed in its credit files a reissued and revised prospectus offering for sale debentures of the issue held by the plaintiffs, which prospectus recited the security for the debentures as including the same shares of 'Penn Central', 'Ohio Electric' and 'Michigan Electric' mentioned in the earlier prospectus and *which prospectus still failed to mention any power of substitution"* (R. 122). (Emphasis ours.)

"The stock which CHASE NATIONAL permitted NEP to "withdraw was at the time of the withdrawal and at all "times thereafter, down to the present, concededly of sub-"stantial value" (R. 87-88).

When Makepeace and his fellow directors found NEP and NPS unable to perform their promise to repay CHASE NATIONAL, as far back as September 1931, they had before them the scheme to withdraw the sound operating company stocks and substitute the common stocks of NPS, the holding company which could not perform its promise to repay CHASE NATIONAL. CHASE NATIONAL'S own exhibit (W W., R. 3546-3547) reads: "The Trustee of NEP debentures to be peti-"tioned for the release of common stock of 'Penn Central' "and 'Ohio Electric' now pledged under the 5% Secured "Debentures. It may be necessary to pledge additional "assets of NEP in order to accomplish this, and for this "purpose we will have available common stocks of NPS." "NPS will purchase from NEP its interest in 'Penn Cen-"tral' and 'Ohio Electric.' Payment therefor to be made "through NPS Class A and Class B common stock." "Cen-"tral Eastern will then acquire from NPS its interest in "'Penn Central' and 'Ohio Electric'."

We have previously referred to the finding that "Make-"peace was informed of pending plans to pay off bank "loans, involving the sale and exchange of properties in

"Ohio * * * and also for public financing by means of 'Ohio "Electric'" (R. 74).

Reid, President of NEP, CHASE NATIONAL's main witness at the trial, was asked why the substitution of which we complain was made. He explained that NEP "had large "bank loans with a difficult situation of refunding these "loans into some form of permanent financing * * * be- "cause the market was not absorbing whatever securities "there might be to offer. * * * We got these stocks out so "that we could carry through these other transactions, and "in that way refund our obligations" (R. 2236). Only by CHASE NATIONAL, as trustee, yielding to its own personal debtor the securities held in trust, could "these bank loans be refunded."

We respectfully maintain that, in point of law, it is sheer euphemism to hold a trustee "guilty of, at least, negli- "gence" who satisfies the first mortgage it holds in trust for its *cestuis* and thereby makes its own second mortgage a first mortgage. NPS was indebted to CHASE NATIONAL. When our operating company stocks were surrendered to that holding company, and we were given its own Class B common stock, CHASE NATIONAL, creditor of NPS, immediately stood senior to the beneficiaries of its trust. The bondholders immediately lost their lien upon the operating properties. CHASE NATIONAL immediately gained a creditor's senior access to this new part of the general estate of its debtor. Our bondholders, however, could not possibly have access to these same assets until CHASE NATIONAL'S loans to the company, whose common stock they now held as security, had been paid in full.

Unfortunately for CHASE NATIONAL, the plan to repay its loans (R. 74, 2276) from the proceeds of public sales[12] of new securities to be issued against our surrendered *res* (R. 2236) was thwarted by the simple honesty of another indenture trustee,[13] with no interest adverse to its bene-

[12]"Halsey Stuart & Company were ready to commit themselves formally for at least a million dollars worth of these Penn Centrals" (R. 2280).

[13]"When the corporate trustee for Municipal debentures refused the necessary consent" (R. 109. cf. 3446-3453).

ficiaries, and no axe of its own to grind. To this extent the contemplated repayment of CHASE NATIONAL from the proceeds of securities released from our trust was blocked. This did not cure the injury already done CHASE NATIONAL'S *cestuis*. Their security was gone just as definitely as if this particular profit to CHASE NATIONAL from traffic in the trust *res* had not been prevented. Once the bondholders' lien on the stock of "Penn Central" was released, it became the free asset of the obligor which previously "had pledged practically every bit of free collateral" (R. 98). CHASE NATIONAL previously had "obtained the notes "and endorsements of subsidiaries of NEP and agreements" "whereby NEP subordinated its claims against important "subsidiaries" (R. 89).

"The bank balances of NEP and NPS in CHASE NA-"TIONAL and other banks had severely declined" (R. 121), and "the Insull situation was difficult" (R. 122). NPS "had been reduced to the necessity of borrowing on life "insurance policies" "for the purpose of meeting year-end "requirements" (R. 97). "Current liabilities of both NEP "and NPS far exceeded the current assets" (R. 98).

"When the corporate trustee for Municipal debentures re-"fused the necessary consent, the 'Penn Central' stock hav-"ing already been withdrawn was thereupon utilized to pro-"vide additional security for New York Trust Company and "to secure from that bank moneys necessary to meet January "1, 1932 financial obligations of the NEP system" (R. 109).

"The release of the securities from under the indenture "enabled NEP to borrow funds thereon sufficient to meet its "January 1, 1932 requirements" (R. 118).

"Of this sum $250,000 was paid to CHASE NATIONAL by "NEP for the payment of semi-annual interest due January "1, 1932, upon the (our) debentures" (R. 119).

Thereby NEP debenture holders received one-half year's matured interest on their debentures, and thereby they lost their entire principal. They were given an infinitesimal part of the proceeds of the *res* removed from their trust, and lulled into a sense of false security, until after the expira-

tion of the four months' moratorium made by their trustee with other banks, *before* "permitting" the substitution.

"CHASE NATIONAL would not have received their payment "February 27, 1932, if NEP had been in receivership on "January 1" (R. 88). "CHASE NATIONAL would not have "received the $500,000 paydown of March 31, 1932, had "NEP entered bankruptcy on January 1" (R. 88-89). "In "the early part of 1932 CHASE NATIONAL *caused* NEP to "assume the obligations to the former of Zeigler, an officer "of NEP, and to subject thereto the collateral under the "CHASE NATIONAL loans to NEP" (R. 83).

These indicate some of the many ways in which our trustee benefitted by the substitution. We shall show just a few of the many other examples with which this record abounds. The Trial Court, although his express findings show that CHASE NATIONAL *both stood to profit* and *did profit* from the substitution, held that it did not contrive or permit this substitution for those reasons (R. 117). A trustee must not be allowed to put itself in a position where this suspicion can even arise. Nevertheless the Trial Court put upon the bondholders the impossible burden of proving that the minds of this National Bank's officers were predominantly fraudulent. By holding it in no sense a fiduciary, he relieved it of the "burdens of explanation and justification". We respectfully ask this Court to bear in mind that his findings of the bank's innocence and good faith are not findings that the bank had explained and justified its conduct; but a Scotch verdict of "not proved guilty".

Not one word in this indenture, which the Trial Court termed "particularly vicious" (R. 3675) directly or indirectly permitted this trustee to take a position adverse to its beneficiaries, the bondholders. On the contrary, merely to allow the trustee to put itself on a position of parity with the bondholders, those who drafted the instrument went out of their way specifically to provide that the trustee might itself purchase or otherwise acquire the same NEP debentures. Section 14 of Article XV of the indenture reads: "The Trus-

"tee acting for itself or as a banker may become a pur-
"chaser, seller, distributor or pledgee of bonds and coupons
"secured hereby with the same rights that it would have if
"it were not Trustee and without liability or accountability
"to the company or the bondholders * * *."

The Trial Court reversed established canons of construction for trust instruments, by interpreting the terms of this indenture loosely in favor of the trustee and strictly against the *cestuis*. It was this construction which made the trust seem more illusory than genuine, despite the fact that the instrument gave the trustee title to the securities deposited, and a duty to use for the bondholders' benefit. In consequence, the Trial Court was preoccupied with the question of the trustee's intent to profit, as distinguished from the fact that it had voluntarily placed itself in an adverse position where it stood to (and in fact did) profit from the substitution.

It was gravely important to CHASE NATIONAL that no receivership of NEP transpire on January 1, 1932. We have already quoted the findings that CHASE NATIONAL's immense loans to Martin Insull and to other high officers of NEP and to Corporation Securities Company, were almost entirely secured by the paper stock of Insull Utilities Investments, Inc., Corporation Securities Company, and "Middle West." NEP was their subsidiary. Its receivership would obviously immediately have wiped out the market value of the collateral held by CHASE NATIONAL for those loans. "CHASE "NATIONAL knew" this "close connection and interdepend-"ence financially" (R. 122-123 cf. R. 68).

Equally important, receivership of NEP would have jeopardized CHASE NATIONAL's claim to the collateral to its loans to NEP and NPS because "CHASE NATIONAL required "among other things resolutions and properly executed sub-"ordination agreements from NEP and its subsidiaries to "further secure the loan to NEP. The general resolution of "NEP authorizing officers to borrow for NEP required the "signatures of two officers. Up to December 21, 1931, only

"one signature had been obtained. CHASE NATIONAL, after "January 1, 1932 required and obtained similar documents "signed by two officers and also dated as of June 13, 1931. "In similar fashion CHASE NATIONAL after January 1, 1932, "obtained from Central Utilities Service Co. an agreement "not to pledge signed by two officers and dated December 4, "1931, in place of one signed by one officer" (R. 86-87).

Without the substitution, there would have been year-end defaults and a receivership. The banks' private receivership, or moratorium agreement, would have been destroyed. The four months' bankruptcy preference period would not have expired. CHASE NATIONAL's shameless dating back (as of six months earlier) of collateral loan agreements could not have taken place, and CHASE NATIONAL might thus have been forced to become the same unsecured creditor of NEP that it had caused its *cestuis* to become, by the fact of the substitution.

We respectfully urge the reading of Findings 134 to 144 (R. 82-84). The opinion (R. 3678) refers to "the startling "conduct of Martin Insull and his colleagues in foisting the "personal under-collateralized loans of various officers of the "Insull system upon Electric Management and Engineering "Corporation, one of the subsidiaries of the system. NEP "and NPS owned this subsidiary." Findings 134 to 144 forcefully indicate how much stronger are the Trial Court's findings, than his published opinion. In this instance they show that it was not so much the conduct of Insull, Reid and Zeigler which was "startling"; as that of our own trustee. These loans were all loans due from said officers to CHASE NATIONAL, upon their own, purely personal, gambling accounts. These Findings further show that it was our trustee who *forced* these officers to have our obligor and its subsidiaries assume their obligations to CHASE NATIONAL. This is another direct instance where this adverse trustee used its position to benefit itself, at the expense of its *cestuis*.

To the same effect we here print, without comment, Finding 115:

"On September 16, 1931 CHASE NATIONAL secured a paydown of $233,495 on the $2,250,000 Martin J. Insull loan by releasing for sale to NEP of $348,500 face amount of the debentures of NPS then held by it as collateral to that loan. These bonds were sold to NEP, with the knowledge of CHASE NATIONAL, at a price of 72, five points above the market, the extra five points being given to Martin J. Insull personally" (R. 78).

Nevertheless, the Courts of New York have refused to use the term "bad faith", or even "gross negligence", by which to characterize the conduct of this important bank. *Quaere:* From the viewpoint of Federal law and policy, may National Banks find exculpation from such conduct?

Following the expiration of the moratorium agreement, first Middle West Utilities Company and then NEP[14] and NPS, went into receivership and bankruptcy. "The obligor "under the debentures, NEP, also became bankrupt in July "of 1932, following a voluntary receivership in June" (R. 88). "NPS went into bankruptcy, and its common stocks, "which had been deposited with CHASE NATIONAL in sub-"stitution for the stocks withdrawn, were then concededly "worthless" (R. 87). CHASE NATIONAL'S Makepeace testified that there was no substantial change in the assets, the value of the assets, or in the liabilities[15] of NPS between the date of the substitution and the date of the bankruptcy (R. 793-794) "The secured debentures of NPS "(senior to the Class A and Class B stock substituted, as "well as senior to the Preferred Stocks and debts, includ-"ing obligations on notes held by CHASE NATIONAL) were "selling at 36 cents on the dollar on the date of the sub-"stitution" (R. 121). Even that 36 cent quotation was fictitiously created by the "pegging operations" as to which

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[14]CHASE NATIONAL attempted to have one of its directors made receiver (R. 3278-3280).

[15]The memorandum estimate of CHASE NATIONAL'S Buckley reads: "* * * there were approximately $22,000,000 of claims and that at the present time the assets consist of cash aggregating about $103,000. Therefore, the probable distribution on claims allowed would be very small and, in no event, would exceed ¼ of 1% and certainly the stock would be worthless." (R. 3273.)

CHASE NATIONAL's witness, Reid, testified (R. 2203-2204). When CHASE NATIONAL, our trustee, participated in this hasty, week-end, transaction by which the entire portfolio of our trust was substituted "the knowledge of CHASE "NATIONAL on the date of the substitution is the sum total "of all of the actual knowledge and information which its "various officers themselves had, as officers, and also all the "material contained in the various credit and investment "files of the bank on that date. The defendant as trustee "comprises all of its officers, its board of directors and its "files. The actual knowledge acquired by Makepeace as a "director of NEP and NPS is to be attributed to defend-"ant, CHASE NATIONAL" (R. 137).

Despite such a record and despite such Findings, the New York Court could go no further than to conclude: "The facts known to CHASE NATIONAL would have deterred "a reasonably careful person from giving up the securities "of the three operating companies for those of more doubt-"ful value of the holding company. CHASE NATIONAL was "guilty of, at least, negligence in permitting the substitu-"tion" (R. 138).

Notwithstanding the restrictions in the trust indenture, the fact still remains that if CHASE NATIONAL had not made this substitution it would not have profited nor would its *cestuis* have lost their money. Neither a trustee, a stakeholder, nor a bystander should escape responsibility under such circumstances. The size of the bank, its reputation, and the high position of its officers involved, cannot change this simple rule of honesty, nor should they be excused by anything written or unwritten. Not alone did this trustee concededly violate the rule of "undivided loyalty"; it furthermore violated the duty of making "full disclosure".

We have shown that this National Bank trustee failed to disclose to its *cestuis* the circumstance of its own adverse interest. It failed to disclose the plan to substitute the trust *res*. It failed to disclose the application for substitution. It failed to notify the bondholders or to call a meet-

ing, as was its right. It failed to disclose that it had elected not to investigate before "permitting" this week-end substitution.

Even after the substitution had been made, it failed to reveal that fact to its *cestuis;* but left it for them to discover for themselves after the bankruptcy of the obligor (R. 61). It resisted all efforts of the Bondholders Protective Committee to ascertain the circumstances surrounding the substitution of December 21, 1931 and affecting its own adverse interests. It bitterly resisted the discovery and inspection proceedings instituted. Its entire attitude is epitomized by the testimony of its president, Aldrich: "I con-"sider this whole suit as an insult to me, if you want to "know the fact. I am not particularly interested in doing "anything in regard to it except what I am directed by the "Court to do" (R. 1490). This lack of candor not only towards its own *cestuis;* but to the court as well, impelled the Trial Court to comment upon the "not always coopera-"tive lips and files of the trustee itself" (R. 3678).

When a National Bank applies to and receives from the Federal Reserve System a special permit to act in a fiduciary capacity, its exercise of such right and privilege carries with it the fundamental duties, disabilities, and obligations springing from any fiduciary relationship.

"The National Banking Act constitutes 'by itself a complete system for the establishment and government of National Banks'." *Deitrick* v. *Greaney,* 309 U. S. 190, 194.

" 'National banks are instrumentalities of the Federal government, created for a public purpose, and as such necessarily subject to the paramount authority of the United States. It follows that an attempt by a state to define their duties or control the conduct of their affairs is absolutely void, wherever such attempted exercise of authority expressly conflicts with the laws of the United States, and either frustrates the purpose of the national legislation or impairs the efficiency of these agencies of the Federal government to discharge the duties for the performance

of which they were enacted. These principles are axiomatic, and are sustained by the repeated adjudications of this court.'

"Our conclusions, upon principle and authority, are that Congress, having power to create a system of national banks, is the judge as to the extent of the powers which should be conferred upon such banks, and has the sole power to regulate and control the exercise of their operations" (*Easton* v. *Iowa*, 188 U. S. 220, 238).

(cf. our brief to the Court of Appeals (R. 3718-3723).)

National Banks do not *ipso facto* possess the right and privilege to act as trustees or in any other fiduciary capacity.[16] Prior to 1913 no National Bank could act in such capacity. Following the decision in *First Nat. Bank* v. *Fellows ex rel. Union Trust Co.*, 244 U. S. 416 and by "Act of "September 26, 1918" "amending Sec. 11 (k) of the Federal "Reserve Act, the Federal Reserve System was empowered "'to grant by special permit to national banks applying "therefor, when not in contravention of state or local law, "the right to act as trustee, executor, administrator, * * * "or in any other fiduciary capacity'". *Missouri ex rel. Burnes Nat. Bank* v. *Duncan*, 265 U. S. 17, 23.

The House Report which preceded the adoption of this amendment of 1918 contains the following significant language, showing that the Congress was mindful of the necessity of protecting the public, as well as the desirability of granting limited privileges to National banks:

"These provisions are intended to impose safeguards upon the exercise of these fiduciary powers by national banks". H. R. No. 479—65th Cong., 2d Sess.

It will be observed that among other protections to the public, regardless of what any lax state rule might permit,

[16]The Federal Reserve System regulations specifically provide: "In passing upon an application for permission to exercise the fiduciary powers authorized by Section 11 (k) of the Federal Reserve Act, as amended, the Board of Governors of the Federal Reserve System will give special consideration to the following matters:" (listing seven specific and one all comprehensive qualification) (Regulation F, Sec. 2).

National Banks acting as fiduciaries are specifically required to keep separate books of account and not to commingle trust funds with others. Under familiar canons of construction the words "or in any other fiduciary capacity" are patently words of limitation. They exclude the possibility of the creation of a non-fiduciary national bank trustee. Limitation to a fiduciary status is the statutory command.

There is no such creature as a non-fiduciary trustee or a non-fiduciary fiduciary. Any capacity which excludes the fundamental duties and disabilities of "undivided loyalty" and "full disclosure" is no fiduciary capacity at all. 3 *Bogert Trusts and Trustees,* Secs. 543, 544, 1935 Ed.; 2 *Scott Trusts,* Sec. 170 p. 856; Restatement of the Law of Trusts Sec. 2 (b), Sec. 170, Sec. 176 (cf. 3717-3718).

Where there has been a breach of these fundamental duties, it inexorably follows if a fiduciary be a fiduciary, that upon him be cast the "burden of justification and ex-"planation". The Trial Judge relieved this derelict trustee of liability because he found it was no fiduciary. He therefore placed the burden upon the beneficiaries to prove by a preponderance of the evidence that the trustee was actually motivated by bad faith. It is interesting to note that, four years after his decision in our case, Justice Rosenman wrote in *Blaustein* v. *Pan American Petroleum & Transport Co.* (174 N. Y. Misc. 601, 671.)

> "As was said in *Hazzard* v. *Chase National Bank* (159 Misc. 57, 83, 84; affd., 257 App. Div. 950; affd., 282 N. Y. 652): 'So strict is the rule of undivided loyalty to the beneficiary that the mere fact that a trustee has an interest inconsistent with the interest of his *cestui,* casts upon him the burdens of explanation and justification. (*Munson* v. *Syracuse, G. & C. R. R. Co.,* 103 N. Y. 58; *Globe Woolen Co.* v. *Utica Gas & Elec. Co.,* 224 id. 483.)'
>
> The case of *Irving Trust Co.* v. *Deutsch* (73 F. (2d) 121; certiorari denied, 294 U. S. 708) shows how high a standard of conduct equity has set for corporate fiduciaries. It also measures the weight of the burden of explanation which is placed upon the trustees."

Grave as are the facts found against CHASE NATIONAL, the record shows how much more rigorous those findings would have been had the Trial Court not so misplaced this all-important burden.

The decision of a State Court which suddenly transmutes the age old prohibition against the assumption by fiduciaries of interests adverse to their cestuis, constitutes in effect a license to such trustees to traffic in the trust res and thereby destroys without due process of law, the rights of beneficiaries to the time honored protection of the equitable arm of the Courts.

This question was directly presented to the Court of Appeals (R. 3723). It is obvious that the holders of these bonds purchased them in the belief that the trustee, supposedly protecting them, would never be allowed by any Court successfully to assume a position adverse to them. Every decision before and since that of the Courts below unalterably opposes such conduct on the part of any fiduciary. Only by holding that a trustee was not a fiduciary could the Trial Court relieve CHASE NATIONAL in the instant case. Only by holding that a trustee is that kind of fiduciary who may relieve himself from all the duties, obligations and disabilities of a fiduciary, could the New York Court of Appeals endeavor to sustain that result. In so doing, the fundamental property rights of our bondholders to a loyal and disclosing trustee were wiped out. There were simultaneously jeopardized, and perhaps in instances also erased, corresponding property rights of the holders of $54,000,000,000.00 in outstanding bonds. To produce this result, the New York State Courts consistently disregarded the written concessions made by the defendant before them, and failed to apply Federal law and policy. Such procedure, it is submitted, unconstitutionally deprived petitioners of their property without due process of law.

Specification of Errors

The New York Court of Appeals erred:

1. In holding that a National Bank trustee may by contract exculpate itself from the minimal fundamental duties, disabilities and responsibilities flowing from the fiduciary relationship, despite Federal law and policy.

2. In failing to hold despite Federal law and policy that a National Bank trustee once it accepts any trust is subjected to the minimal fundamental fiduciary duties of "undivided loyalty" and "full disclosure" to its *cestuis*.

3. In holding despite Federal law and policy that a National Bank trustee which it was decided had voluntarily assumed an "inconsistent" role; had been "guilty of, at least, negligence"; had not acted as "a reasonably careful person"; had made no "disclosure" and had thereby "damaged" its *cestuis;* was not charged by law with the "burdens of justification and explanation."

4. In failing to hold that the standard of the duties of CHASE NATIONAL when acting as a trustee under the National Banking Act is measured by Federal law.

5. In holding that the duties of a National Bank trustee to its *cestuis* may be abridged and restricted by contract thereby impairing, impeding and frustrating the public purposes and National policy of the National Banking Act.

6. In failing to hold that CHASE NATIONAL, a National Bank trustee, was subjected to the disabilities of a fiduciary, thereby nullifying the Federal safeguards and protection clearly intended under the National Banking Act for the protection and safeguard of petitioners and the investing public.

7. In holding despite Federal law and policy, that the duties and liabilities of a National Bank trustee can be limited and restricted solely and exclusively to the provisions of an agreement.

8. In holding that the liability of CHASE NATIONAL "though acting as a fiduciary was limited by the terms of the trust agreement", despite Federal law and policy.

9. In holding that CHASE NATIONAL was not subjected to the duties and liabilities of a fiduciary, and thereby, arbitrarily and capriciously, in violation of settled principles of law, contrary to the concessions of CHASE NATIONAL and the force of undisputed facts, violating a Federal right of petitioners and unconstitutionally depriving them of their property, without due process of law.

10. In affirming the judgments entered upon the decision of the Trial Court and of the Appellate Division of the Supreme Court of the State of New York for the First Judicial Department, dismissing petitioners' complaint and refusing to grant the relief prayed for in their complaint against CHASE NATIONAL.

Reasons for Granting the Writ

1. The New York State Courts have decided Federal questions of substance not theretofore determined by this Court (cf. Rule 38; 5(a) of Rules of this Court).

Again and again this Court has considered and defined the powers, rights, privileges and immunities of National Banks *but never their fiduciary duties, obligations or disabilities.* This case then is one of first impression involving the construction, application and interpretation of such duties and disabilities of a National Bank permitted under Federal law to act as a "trustee" "or in any other fiduciary capacity".

This Court has frequently considered cases concerning National banks. At its last term, for example, the following cases were decided: *Colorado National Bank* v. *Bedford,* 310 U. S. 41; *City of Yonkers* v. *Downey,* 309 U. S. 590; *Inland Waterways Corp.* v. *Young,* 309 U. S. 517; *Deitrick* v. *Greaney,* 309 U. S. 190. See, too: *Texas & P. R. Co.* v. *Pottorff,* 291 U. S. 245; *Marion* v. *Sneeden,* 291 U. S. 262; *Awotin* v. *Atlas Exch. Nat. Bank,* 295 U. S. 209. This Court has

squarely considered and determined the power of National banks to act as trustees, etc. *First Nat. Bank* v. *Fellows, ex rel. Union Trust Company,* 244 U. S. 416; *Missouri ex rel. Burnes Nat. Bank* v. *Duncan,* 265 U. S. 17; *Ex Parte Worcester County Nat. Bank,* 279 U. S. 347; but not, so far as diligent research discloses, the duties, obligations, liabilities and disabilities of National Bank fiduciary trustees.

The New York State Courts, however, have attempted such consideration, determination and definition.

2. This case has been decided by the New York State Courts in a way probably not in accord with applicable decisions of this Court (cf. Rule 38; 5(a)).

While we have not found a single decision of this Court which considered, determined and defined the duties and disabilities of a National Bank fiduciary trustee, there are obviously many applicable decisions of this Court concerning the duties and disabilities of those acting in fiduciary capacities.

Nearly a century ago, this Court determined that those who acted in a fiduciary capacity would be held to the highest fidelity.

> "The general rule stands upon our great moral obligation to refrain from placing ourselves in relations which ordinarily excite a conflict between self-interest and integrity * * *. It acts not on the possibility that, in some cases, the sense of that duty may prevail over the motives of self-interest, but it provides against the probability in many cases, and the danger in all cases, that the dictates of self-interest will exercise a predominant influence, and supersede that of duty." *Michoud* v. *Girod,* 4 How. 503, 555.

To the same effect: *Jackson* v. *Smith,* 254 U. S. 586; *Chicago M. & St. P. R. Co.* v. *Des Moines U. R. Co.,* 254 U. S. 196, 220; *Magruder* v. *Drury,* 235 U. S. 106, 119; *Geddes* v. *Anaconda Copper Mining Co.,* 254 U. S. 590, 599; *Pepper* v. *Litton,* 308 U. S. 295.

3. There is a direct conflict between the decisions of the New York State Courts and decisions of the Circuit Court of Appeals for the Second Circuit.

The State Courts have now expressly limited and restricted the duties of a mortgage trustee to the express words of the trust indenture. The said Circuit Court of Appeals on the contrary has determined that there are certain fundamental duties implied from the fiduciary relationship which cannot be obliterated by contract. *Miles* v. *Vivian*, 79 Fed. 848, 851; *Frishmuth* v. *Farmers' Loan & Trust Co.*, 107 Fed. 169. See also: *Kelly* v. *Central Hanover Bank & Trust Co.*, 11 F. Supp. 497, 509 (rev'd upon grounds immaterial here 85 F. (2d) 61).

4. There is a direct conflict between the Court of Appeals of the State of New York and the decisions of the highest Courts of other states.

The highest courts of states other than that of New York have expressly charged fiduciaries with implied fundamental duties which flow from the fiduciary relationship. *State* v. *Comer*, 176 Wash. 257; *Marshall & Ilsley Bank* v. *Guaranty Investment Co.*, 213 Wisc. 415; *Richardson* v. *Union Mortgage Co.*, 210 Ia. 346 (cf. opinion of Trial Court in this case R. 3669).

5. This case is one of vast public interest and importance.

(a) The petitioners herein are some 125 bondholders of NEP selected by their committee, and are residents of states throughout the Union. They include National and State banks.

(b) The interests of thousands of bondholders of NEP throughout the country will be directly affected by the result here attained.

(c) Most of the bondholders purchased their securities in interstate commerce and through the use of the mails.

6. The determination of the New York State Courts, if unchanged, destroys the public safeguards and protection clearly intended for the investing public by the National Banking Act.

Those New York Courts have squarely held that a National Bank trustee can contract away its fiduciary obligations. It has been recognized for generations that "sala-

"bility" of mortgage bonds to the public "depends in no in-"considerable degree upon the character of the persons who "are selected to manage the trust." (*Knapp* v. *Troy and Boston R. R. Co.*, 87 U. S. 117.) It was expressly found in our case that the bondholders "relied" upon CHASE NATIONAL and that it "represented" that "it would exercise its experience, "power, financial acumen" and "integrity" "to serve as a pro-"tection to them for their investment" (R. 61-62). Should the New York State Courts' determination be allowed to stand, National Bank trustees not only fail to protect the public, but in the language of the Trial Court may lend their quasi-governmental prestige to instruments which "have all "the potentialities of fraud upon innocent investors" (R. 3675). It is inconceivable to us that this Court will allow National Bank trustees to become active instrumentalities of fraud when public investors purchase securities upon the supposed protection afforded them by the National Banking Act and Federal agencies.

7. The importance of this case, at least in part, impelled Congress to enact the Trust Indenture Act of 1939 (the Barkley Act) (15 U. S. C. A. Sec. 77aaa, *et seq.*; Supp. 1939) (cf. frequent quotations of and references to the opinion of the Trial Court by the Securities & Exchange Commission, in Report VI "Trustees Under Indentures", issued June 18, 1936, and later report numbered VIII, issued September 30, 1940, p. 341, note 13). Very many texts, legal periodicals, and decisions considering trusts, and particularly those involving mortgage indenture trustees, have since 1936 referred to the opinion of the Trial Court.

While this Act may, in the future, prevent certain frauds and injustices to the investing public, by its terms it is inapplicable to existing indentures. The best available statistics indicate that upwards of $54,000,000,000.00 of the public's money is invested in corporate mortgage indenture bonds similar to that here involved. Such issues, totally unaffected by the Indenture Act of 1939, have a great many years yet to run—in some instances, more than fifty (R. 3714). In this case, the Trial Court pointed out that "this

"defendant, alone, at the time of the substitution was acting "as trustee under 850 similar indentures, totalling about "$5,000,000,000" (R. 3674). Billions of dollars of public money have been invested, in a great measure upon the supposed security afforded the investors by the National Banking Act and Federal agencies.

Many of these National Bank trustees are located in the State of New York. The investors who purchased the bonds, however, reside throughout the country and include both National and State banks. It is conceivable that each of the forty-eight States may by statute or decision set up its own standard of fiduciary obligation applicable to National Bank trustees. The rights and remedies then of each *cestui* may depend wholly upon the law and policy of that particular State in which suit is instituted. Unless the decision reached below is changed and this Court hold all National Bank Trustees, wherever located, to minimal Federal standards of fiduciary obligation, the practical result will be that each State, not the Congress or this Court, will be the final arbiter in its own jurisdiction to determine, construe, and define the duties and disabilities of National Bank fiduciary trustees.

Conclusion

Wherefore, it is respectfully submitted that this petition for a writ of certiorari should be granted.

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